In the Supreme Court of the United States.

MARGARET C. LYNCH, EXECUTRIX OF the Last Will and Testament of E. J. Lynch, Deceased, petitioner,
v.
ALWORTH-STEPHENS COMPANY, RESPONDENT.

No. ——.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

The Solicitor General, on behalf of Margaret C. Lynch as executrix of the last will and testament of E. J. Lynch, deceased, formerly Collector of Internal Revenue for the District of Minnesota, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit entered in the above case on November 12, 1923, affirming the judgment of the District Court for the District of Minnesota.

STATEMENT OF THE CASE.

This is an action instituted by the Alworth-Stephens Company, a mining corporation, against E. J. Lynch as Collector of Internal Revenue for the District of Minnesota to recover back the sum of $21,045.91, Federal income and excess-profits taxes paid for the

year 1917, assessed and collected under the provisions of the Revenue Act of 1916, as amended by the Revenue Act of 1917. The District Court for the District of Minnesota gave judgment for the plaintiff in the sum of $20,322.89, and on appeal to the Circuit Court of Appeals for the Eighth Circuit the judgment was affirmed. The Collector of Internal Revenue, E. J. Lynch, having died subsequently to the trial of the case in the District Court, Margaret C. Lynch as executrix was substituted as plaintiff in error in the Circuit Court of Appeals.

During the year 1917 the plaintiff held leases of two mines—namely, the Perkins Mine and the Hudson Mine—in accordance with the terms hereinafter stated.

It had a lease of the Perkins mine, with the right to explore for and remove iron ore for 50 years, made in 1908, by the terms of which it was under an obligation to pay to the lessor, the owner of the mine, 30 cents for each ton of ore taken from the mine. It subleased these rights in 1908 to one Lutes, who agreed to pay 75 cents per ton for every ton taken from the mine, and the mine was operated in 1917 by an assignee of Lutes under the lease to him, so that the plaintiff received 45 cents per ton of the ore extracted during that year. It had a lease for 50 years of the Hudson mine, with the right to explore for and remove iron ore, made by the fee owners thereof in 1909, under which it was required to pay to the lessors 30 cents per ton for the ore taken from the mine. In 1909 it subleased these rights to the

Syracuse Mining Company, which agreed by the terms of the lease to pay to it 60 cents per ton for every ton taken from the mine, and this mine was operated under this lease in 1917.

The plaintiff's entire income for 1917 was derived from the rents and royalties received from the subleases of the Perkins and Hudson mines. The plaintiff instituted the present action to recover back the sum of $21,045.91, claiming that it was entitled, under the provisions of the statutes quoted below, to a deduction for depletion of its ore properties as representing a return of capital assets, and to classification as a corporation having no invested capital or not more than nominal capital.

The District Court found that the plaintiff had an invested capital on January 1, 1917, of the sum of $25,000, and held that such amount was more than a nominal capital and that the plaintiff was taxable under Section 201 of the Revenue Act of 1917; this was affirmed by the Circuit Court of Appeals.

The District Court, however, held that under the provisions of the statutes quoted below the plaintiff was entitled to deduct from its total net royalties received during 1917 the market value on March 1, 1913 (which it found to be 71.9 per cent of the total of the receipts), of the plaintiff's property interest in the ore in the mines which was extracted during 1917.

The respondent maintains and contends that it is entitled as lessee of the mines to a deduction for depletion in figuring its net taxable income for the year 1917.

The petitioner, however, contends that under the provisions of the statutes quoted below this right to a deduction for depletion is restricted to the lessors who were owners in fee of the mines to the exclusion of the lessees.

QUESTION.

Is the lessee of mining property entitled to deduct from gross income an allowance for "depletion" under the provisions of the Revenue Act of 1916?

STATUTES INVOLVED.

REVENUE ACT OF 1916.[1]

(Act of September 8, 1916, 39 Stat. 756, 765–770.)

> SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized, but not including partnerships, a tax of two per centum upon such income; * * *.
>
> SEC. 12(*a*). In the case of a corporation, joint-stock company, or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—
>
> First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties; * * *.

[1] Section 4 of the Revenue Act of 1917 imposed a tax of 4 per cent in addition to that levied by Section 10 of the Revenue Act of 1916.

Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (*a*) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow but by the settled production of regular flow; (*b*) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (*a*) and (*b*) under rules and regulations to be prescribed by the Secretary of the Treasury. *Provided*, that when the allowance authorized in (*a*) and (*b*) shall equal the capital originally invested, or in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; * * *.

Third. The amount of interest paid within the year; * * *.

Fourth. Taxes paid within the year * * *.

REVENUE ACT OF 1917.

(Act of October 3, 1917, 40 Stat. 300, 302–307.)

Sec. 201. That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid

for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income: (here follow the percentages) * * *.

Sec. 203. That for the purposes of this title the deduction shall be as follows, except as otherwise in this title provided—

(a) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) $3,000; * * *.

REASONS FOR GRANTING THE PETITION.

1. The construction of Section 12(*a*) of the Revenue Act of 1916, allowing a deduction in the case of mines of "a reasonable allowance for depletion" has never been directly passed upon by this court, but in the case of *Weiss, Collector*, v. *Mohawk Mining Company*, 264 Fed. 502, the Circuit Court of Appeals for the Sixth Circuit held that a lessee of mining property was not entitled to any allowance for depletion under the provisions of the Revenue Act of 1916, and this court denied a petition for certiorari, 254 U. S. 637.

2. The Circuit Court of Appeals for the Eighth Circuit in the case at bar has refused to follow the rule laid down in the *Mohawk Mining case, supra*, and the opinions of the two courts are in direct conflict. The opinion of the Circuit Court of Appeals for the Eighth Circuit states:

> Counsel cite and seem to rely upon the opinion of the Circuit Court of Appeals of the Sixth Circuit in *Weiss* v. *Mohawk Mining Company*, 264 Fed. 502, in which that court held that the lessee in that mining case was not entitled to a reasonable allowance for depletion of the value of its property right in the royalties to accrue to it under the leases of the mine. The opinion in the *Weiss case* has been carefully read and studied, but, after careful consideration, notwithstanding our great respect for and deference to the judges who concurred in that opinion, it has not proved persuasive.

3. In auditing thousands of returns of mining companies under the provisions of the Revenue Act of 1916 the Department has followed the decision in the *Mohawk Mining case* and has allowed depletion only to the fee owner of mineral lands, and no depletion to a lessee. If the rule laid down in the Eighth Circuit is sustained, refunds of approximately ten million dollars will necessarily be made to lessees.

4. If the rule established by the District Court and affirmed by the Circuit Court of Appeals for the Eighth Circuit that no income or profit on ore removed is realized until the capital value is returned

represents the correct rule, then the amount of refunds of taxes paid by lessees would amount to an additional ten million dollars. And if the same rule is also applied to lessors under the decision of the Circuit Court of Appeals for the Eighth Circuit, then there will be an additional refund of seven million dollars.

5. In holding that the lessee of mining property is entitled to depletion under the provisions of the Revenue Act of 1916, the Circuit Court of Appeals for the Eighth Circuit has utterly disregarded and refused to follow the fundamental principles announced by this court in the cases of *Stratton's Independence* v. *Howbert*, 231 U. S. 399; *Stanton* v. *Baltic Mining Company*, 240 U. S. 103; *Von Baumbach* v. *Sargent Land Company*, 242 U. S. 503; *United States* v. *Biwabik Mining Company*, 247 U. S. 116; *Goldfield Consolidated Mines Co.* v. *Scott*, 247 U. S. 126; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179.

Therefore, it is respectfully submitted that this petition for a writ of certiorari to review the decree of the Circuit Court of Appeals for the Eighth Circuit should be granted.

JAMES M. BECK,
Solicitor General.

BRIEF IN SUPPORT OF PETITION.

The decision of the Circuit Court of Appeals for the Sixth Circuit in the case of *Weiss* v. *Mohawk Mining Company*, 264 Fed. 502, and the decision of the Circuit Court of Appeals for the Eighth Circuit in the case at bar are diametrically opposed and cannot be reconciled. Which rule is to be followed can only be finally determined by this court.

The long prevailing rule and principle announced by this court, which the Circuit Court of Appeals for the Sixth Circuit followed in the case of *Weiss* v. *Mohawk Mining Company*, is that the entire proceeds derived from mining operations constitute income and profit without deduction for original cost or capital invested. The income derived from mining operations is distinguished by peculiar principles and by special rules which have been recognized for a long period of years by both the courts and legislative bodies. These rules and principles are founded upon the distinctive character of mining properties and their particular method of operation.

These principles have been recognized by this court in many cases, particularly *Stratton's Independence* v. *Howbert*, 231 U. S. 399, at page 413.

This court has held that there is no inherent right to a deduction for depletion.

Goldfield Consolidated Mines Co. v. *Scott*, 247 U. S. 126.

Stanton v. *Baltic Mining Co.*, 240 U. S. 103.

Von Baumbach v. *Sargent Land Co.*, 242 U. S. 503.

Depletion as used in the Revenue Act of 1916 means an exhaustion of capital assets, and any such exhaustion constitutes a loss to the fee owner of the property, not to a lessee. The lessee loses nothing. A lessee bargains with the fee owner to mine out the mineral content of the land. The land of the fee owner is thereby depleted, but no depletion is suffered by the lessee as such. His income is represented by the proceeds of the sale of ore less expenses incurred. His object is to exhaust the ore, and the exercise of this privilege is all that he pays for. If, as in the case at bar, the lessee transfers all of his rights under lease to an operating company, he transfers his privilege in consideration of the payment of royalties. He transfers only the right which he held as lessee. The amount received as royalties represents his income. The operating company exhausts the ore, and the land of the fee owner alone is depleted by the amount of ore extracted and removed.

It has been repeatedly held by this court, and the rule definitely established, that leases upon ore lands in Minnesota are not conveyances of the ore in place but are simply grants with the privilege to explore for, mine, and remove the minerals from the land.

Stratton's Independence v. *Howbert*, 231 U. S. 399.

Stanton v. *Baltic Mining Co.*, 240 U. S. 103.

Von Baumbach v. *Sargent Land Co.*, 242 U. S. 503.

United States v. *Biwabik Mining Co.*, 247 U. S. 116.

Goldfield Consolidated Mines Co. v. *Scott*, 247 U. S. 126.

Doyle v. *Mitchell Bros. Co.*, 247 U. S. 179.

Weiss v. *Mohawk Mining Co.*, 264 Fed. 502.

In the case of *United States* v. *Biwabik Mining Company*, 247 U. S. 116, it was held that the lease involved was not to be construed as the conveyance of the ore in place, although the latter could be measured with substantial accuracy. The court says at page 125:

> The lessee takes from the property the ore mined, paying for the privilege so much per ton for each ton removed. He has this right or privilege under the form of lease here involved so long as he sees fit to hold the same without exercising the privilege of cancellation therein contained. He is, as we held in the *Sargent Land Co. Case*, in no legal sense a purchaser of ore in place.

In the case of *Weiss, Collector*, v. *Mohawk Mining Company*, 264 Fed. 502, it was held the Mohawk Mining Company because it was a lessee only was not entitled to the allowance which it was admitted would be rightful if it were the fee owner. The court at page 505 uses the following language:

> In *United States* v. *Biwabik Co.*, 247 U. S. 116 (arising under the act of 1909), it was ruled, after full consideration, that under a lease, practically identical with the Mohawk lease now involved, the nature of the interest

> held by the lessee was not such as to permit it to claim the allowance, but that the contingencies which attended the character of the lessee's interest barred it from claiming that its capital assets had been diminished. It is true that the question whether the mining of ore could be considered depreciation in any event was underlying, and that this question has been completely removed by the amendment of 1916; but the Supreme Court did not rest its conclusion at all upon the definition of depreciation.

The court further states that it can conceive no substantial distinction as applied to a mine between the depreciation as sought by mine owners under the earlier act and that depletion which was expressly allowed by the amendment of 1916. On petition for rehearing the court says, at page 506:

> We cannot read the decisions of the Supreme Court as having determined that the exhaustion of ore reserve is so inherently a business loss, rather than an impairment of capital, that a statutory grant of the right to deduct for depletion on that account will reach a case which has been adjudged not to involve the diminution of capital assets.

A petition for a writ of certiorari in the *Mohawk Company case* was denied. (254 U. S. 637.)

This court has approved and applied under the terms of the Revenue Act of 1916, Section 12 (*a*), which governs both the *Mohawk Company case* and the instant case, the same rule regarding the claim of

a lessee of mines for a deduction on account of impairment of capital assets which it had previously applied under earlier revenue acts.

The Department has consistently followed the rules laid down by this court and by the Circuit Court of Appeals for the Sixth Circuit in the case of *Weiss* v. *Mohawk Mining Co.*, *supra*, and thousands of cases of mining companies have been settled and taxes paid under the rule of the Sixth Circuit. The decision of the Circuit Court of Appeals for the Eighth Circuit in the case at bar disregards the principles heretofore laid down by this court and refuses to follow the rule laid down by the Sixth Circuit. The Eighth Circuit holds, first, 'that the Revenue Act of 1916 grants to the lessor, the lessee, and the fee owner, and to other corporations who were on March 1, 1913, the owners of valuable property rights and interest in mines, a reasonable allowance for depletion, and, second, holds that no net income is received by a lessee or lessor until the capital value as of March 1, 1913, has been repaid.

If the rule now announced by the Circuit Court of Appeals for the Eighth Circuit is correct, then the principles laid down by this court in many adjudicated cases are fundamentally wrong. If this court accepts the rule of the Eighth Circuit it must necessarily overrule its prior adjudication.

It is respectfully submitted that the rule in the Sixth Circuit, which follows the prior cases decided by this court, is correct, that the decision in the

Eighth Circuit is erroneous, and that the petition for certiorari should be granted to finally establish the rule to be followed.

JAMES M. BECK,
Solicitor General.

FEBRUARY, 1924.